

CIA/OER/SO-06806-75 IMPACT OF INFLATION
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Impact of Inflation and Recession
on the USSR and Eastern Europe

The USSR has been helped and Eastern Europe hurt by the rise in oil and raw material prices in 1973-74.

- Soviet terms of trade vis-a-vis the West improved, and the Soviet hard currency balance of trade was in surplus for the first time in seven years.
- Eastern Europe's terms of trade with the West deteriorated, and its trade deficit increased sharply.

Western inflation and recession are affecting both the USSR and Eastern Europe.

- Some raw material prices are falling, prices of manufactured goods are rising, and the terms of trade are beginning to go against the USSR.
- On the other hand, the Soviets are able to extract more trade concessions from Western countries because of their desire to expand exports.
- Eastern Europe will be hurt by higher Soviet prices this year and has been hurt by deteriorating market conditions in Western Europe. Economic growth and the growth of consumer welfare is likely to be cut back.

Soviet economic control over Eastern Europe is being strengthened because of Eastern Europe's increasing dependence on relatively low-priced Soviet fuels and raw materials.

Moscow, reluctant to extract political gains from economic problems in Europe, is urging Western communist parties to pursue gradualist policies rather than take radical action that could jeopardize Soviet detente policy.

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Communist-type economies by their nature are protected from the vagaries of the world capitalist market. Prices are administered, and there is no systematic relationship between domestic prices and foreign trade prices. If higher prices are paid for imported Western goods, for example, the difference between the domestic price and the foreign trade price is covered by state subsidies, leaving domestic price levels unaffected. The Soviets have been more successful than the Eastern Europeans in insulating their economy from world market conditions largely because Soviet foreign trade accounts for a small share of GNP. In the USSR, total imports are only about 3% of GNP and imports from the West, roughly 1%. For Eastern Europe it is 15% and 5%, respectively.

USSR

As the USSR has increased its trade with the West, Western economic conditions have become more important to the Soviet economy. Western equipment and technology is an ever growing element in the Soviet scheme to upgrade its industry.

Imports from the West are limited by earnings from exports of goods and gold and by credit availability. The rapid increase in oil, raw material, and gold prices has greatly strengthened Moscow's ability to import from the West. The dollar value of Soviet exports to the West rose by more than 50% in 1973 and

apparently increased substantially in 1974, although demand for Soviet raw materials may have weakened in the latter part of 1974. The Soviets had a trade surplus in 1974 for the first time in seven years as a result of high oil and raw material prices. From a deficit of \$1.7 billion in 1973, the Soviet hard currency surplus reached perhaps \$1 billion.

The slackening of demand and lower prices for some Soviet exports -- e.g., platinum, diamonds, copper, and wood -- probably resulted in a decline in earnings for these commodities; the lower prices should remain in effect for the balance of 1975. But under 1974 agreements Soviet gas prices will be higher and coal and oil prices also should stay up in 1975, although the volume of oil deliveries may decline. Another surplus in 1975 is probable.

Western inflation has also led to a rapid increase in the prices the USSR has paid for its purchases in the West. In some instances the Soviets have been forced to accept price escalation clauses in purchase contracts; in other cases they found that the cost of equipment has greatly increased. Prices charged by International Harvester for crawler tractors ordered by the USSR last fall, for example, were increased by 85% over previous levels.

The deepening recession has resulted in a marked slowdown in the rise of Western export prices as well. In contrast to 1974, when increases in annual export price indices of major

Soviet suppliers ranged from 17% (West Germany) to over 50% (Italy), the rise in export prices during 1975 is expected to average around 5%. The leveling off in prices will directly benefit Soviet buyers, who are in the process of placing several billion dollars of orders in support of the 1976-80 plan. Since mid-1974, the USSR has ordered over \$3 billion in machinery and equipment and an additional \$2 billion in large diameter pipe.

As a major potential buyer in a depressed market the Soviets have been able to exact economic concessions from Western governments. Since December 1974 the USSR has received over \$6 billion in low-interest credit lines from the UK and France and could receive an additional \$1 billion or more from Japan and Italy in 1975. As indicated by the recently signed USSR-UK cooperation agreement, Western governments may also prove more willing to support the long-term commodity pay-back deals increasingly favored by Moscow. The Soviets have accumulated a medium-term and long-term debt to the West of more than \$4 billion already. Judging by its recent capital goods purchases and current negotiations, they are willing to run it up considerably more -- particularly if they believe the inflation rate will exceed the interest rates they are getting on these credits.

The rapid increase in Soviet export prices during 1973-74 has far outweighed the higher prices of Soviet imports of manufactures from the West, and Moscow's terms-of-trade remain significantly improved over 1972. Moscow has also benefited from higher prices for gold. Whereas Moscow used to sell gold only to

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help cover trade deficits -- roughly 450 tons were sold in 1972-73, earning about \$1.3 billion -- it was also selling gold in 1974 to take advantage of high prices. Continued uncertainty in the West should keep gold prices high, enabling Moscow to earn \$1 billion or more per year from sales out of current production. Meanwhile the Soviets are successfully increasing their output of gold every year.

The USSR has demonstrated a continuing, but fluctuating need for many food products produced in the West and currently has the financial ability to purchase large amounts at any given time. As a result, Soviet purchases, or even the threat of purchases, can have a significant impact on world food prices, especially grain. Even good Soviet harvests will not preclude the import of specific types of grain, such as corn and high-quality milling wheat. One large grain exporter who has close Soviet contacts believes that the USSR will "normally" buy 4-6 million tons of corn and "periodically" buy 1-3 million tons of wheat, barring serious crop shortfalls. Eastern Europe also has a continuing need for Western feed grains, in particular to support their growing livestock programs.

In most international markets the Soviets play a passive role, accepting market conditions as given. Thus, Moscow has profited greatly from high raw material prices in recent years, while usually not causing these increases. The Soviets followed OPEC in raising oil prices, but they have not profited much from non-oil cartels, mainly because the latter have enjoyed only limited success. The copper cartel -- CIEPEC -- has had some success in supporting prices, and Soviet copper earnings have probably been aided somewhat, but

mercury, for example -- have failed. Moscow, however, has profited from the anticipated US embargo on Rhodesian chrome by raising the price of Russian chrome ore by 165% in January 1975. In the rapid run-up of sugar prices late last year, the Soviets were a major factor. At the time there were rumors that the Soviet purchases were speculative, but no concrete evidence of this has emerged.

Eastern Europe

In 1974, Eastern Europe was confronted by higher prices for imports of Western machinery and equipment as well as for semimanufactures and raw materials. The prices for East European exports to the West also rose, but much less than import prices. The resulting decline in terms of trade varied from one country to another, depending largely on its raw material resources. Thus, Romania and Poland, whose exports feature a substantial volume of fuels and raw materials, fared much better than the rest.

In addition to its deteriorating terms of trade, Eastern Europe suffered another reversal: a slump in demand for some of its exports owing to the recession in the West. Overall, Poland and Romania managed to increase the volume of their exports, largely because of greater deliveries of energy products. For the others, little volume increase, if any at all, was registered. Higher prices explained most of the growth in the value of exports.

The unfavorable development in prices and markets combined to produce a total East European deficit of \$4.5 billion, nearly twice the deficit of 1973. Poland's deficit increased by nearly \$900 million to \$2.1 billion, and accounted for nearly half the total East European deficit. The deficits were covered largely by increased drawings on Western government guaranteed credits and through other borrowing. Eastern Europe's

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debt to the West, which had already reached about \$10 billion at the end of 1973, was substantially higher at the end of last year.

The East Europeans depend more on foreign trade than the USSR and ordinarily would have suffered severe hardships because of the reversal in their terms of trade and export markets. But they were able to mitigate the impact of these developments on their economies because more than half of their trade in 1974 was conducted with other CEMA countries at stable prices. Also, the availability of Western credits allowed the East Europeans to continue to secure other materials vital to maintaining production in major industries. Thus, the East European economies managed to grow at an above average pace -- from 6% in Czechoslovakia to more than 15% in Romania -- in spite of the deepening recession in the West.

Still conscious of the Polish riots in 1970 over higher prices, the East Europeans made extensive use of budget subsidies in 1974 to insulate their domestic economies from the impact of Western inflation. Most retail prices were stable in 1974, although the desire to conserve oil prompted the East Europeans to raise domestic fuel prices. To a small extent, consumers were charged higher prices through changes in the assortment of merchandise available to the public. For example, like the USSR, Eastern Europe was affected by deterioration in the quality of goods and the disappearance of cheaper varieties from the shelves.

Eastern Europe is likely to incur another sizable deficit in its trade with the West in 1975. Attempts to save foreign exchange by cutting back on non-essential Western imports are likely to be thwarted by more prices rises in the West. Meanwhile, attempts at increasing exports will continue to be frustrated by Western recession. In anticipation of these developments, the East Europeans have already obtained some commitments for Western credits to cover the anticipated deficits and are seeking other loans, particularly from OPEC countries. If the necessary financing does not materialize, Eastern Europe will have to cut back sharply on imports from the West.

Economic growth in 1975 is likely to fall short of the 1974 pace. Increases in prices with other CEMA countries, particularly for Soviet raw materials, will place further strains on the East European economies. Domestic endowment of raw materials will allow Poland and Romania to continue to boost industrial production, but others will have to cut back on growth plans. Moreover, as prices continue to rise each year, long-term planning becomes more problematic.

The sectors hardest hit by higher costs or any cutbacks in fuel supplies would be chemicals, metallurgy, agriculture, and food processing. These are the industries relying most on imports of Western equipment and basic materials, which also may be trimmed. Consumer industries, such as textiles,

leather, wood, and paper, may require more investment and output to satisfy Moscow's desire for additional consumer goods from Eastern Europe.

The requirement to boost exports to both the West and the USSR will leave fewer goods for domestic consumption. Planners will have to slow down the growth of real income and increase some retail prices. The Hungarians in January 1975 and the Poles in February 1975 have already raised retail prices for some goods that incorporate high-priced Western materials, and the other East European countries are likely to follow.

Soviet-East European Economic Relations

Eastern Europe conducts almost one-third of its trade with the Soviet Union.* The USSR traditionally has been Eastern Europe's main supplier of oil and many raw materials essential to the viability of these economies. The USSR supplies more than three-fourths of Eastern Europe's imports of crude oil, and the bulk of its imports of iron ore, pig iron, lumber, and the like. These countries have obtained goods from the USSR without the expenditure of scarce hard currency and at bargain prices. For a number of years the USSR has not been happy with its terms of trade vis-a-vis Eastern Europe, selling high-cost raw materials at low prices for what it considered overpriced machinery and equipment.

* The share of Eastern Europe in Soviet trade was 46% in 1974.

To offset its disadvantage, the USSR has insisted in recent years that the East Europeans purchase more Soviet machinery, buy more oil in the West, and invest in Soviet raw material projects as a guarantee of future deliveries. Despite adjustments stemming from these demands, the USSR still considered itself at a disadvantage in trade with Eastern Europe, and when prices of oil and other raw materials rose steeply in world markets, the Soviets refused to increase this disadvantage.

The Eastern Europeans had expected the USSR to maintain prices until the end of the current five-year plan period -- through 1975. The Soviets, however, have already boosted the price for most oil deliveries from \$3 a barrel to about \$7 -- still well below world prices. This will increase Eastern Europe's bill for Soviet oil by \$1.5 billion -- equivalent to about 13% of its exports to the USSR in 1974. In addition, the Soviets are raising prices on a wide spectrum of other raw materials, but most of these prices will also be below world market levels. The resulting worsening of Eastern Europe's terms of trade with the USSR will vary with each country, according to its dependence on imports of raw materials.

Moscow probably will grant concessions to those hardest hit -- Czechoslovakia, East Germany, Bulgaria, and Hungary -- in order to prevent severe strains on their economies. The Soviets will probably be more generous in 1975 than subsequently

since the East Europeans have already drawn up their plans at the old prices. The Hungarians have already been promised ten-year credits. Moscow may not be as forthcoming to countries such as Poland and Romania, which rely less on Soviet raw materials.

Despite these concessions, East European terms of trade with the USSR will continue to worsen during the next few years. Intra-CEMA prices reportedly are to be recalculated annually on the basis of the previous five-year average world price. World prices for many raw materials have begun to level off or even decline, but CEMA prices will continue to rise for several years as low-priced years are dropped from the formula. Assuming a moderate rise in world prices, the East Europeans could be paying \$12 a barrel for Soviet crude by 1980.

Concessions by the USSR are meant to prevent major economic disruptions in Eastern Europe, but they will also serve Moscow's political ends. Concessions in return for closer Eastern European ties to the USSR clearly promote Soviet policy toward CEMA integration and measurably strengthen Moscow's economic control over Eastern Europe.

Economic benefits accruing to Moscow include the greater availability of investment funds for Soviet projects and increased supplies of Eastern European goods. About 30% of Soviet imports from Eastern Europe is made up of consumer

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goods and substantially increased imports of such goods will

make the Soviet consumer happier. Fewer goods will be left
for consumption in Eastern Europe, but leaders in these
countries cannot afford to ignore the lessons of the Polish
riots in 1970 when prices were raised to dampen demand.

Impact of World Energy Situation
on the USSR and Eastern Europe

The USSR is the only industrial country in the world that is self-sufficient in energy. Oil is the USSR's major energy export, and, indeed, its major export, and the sharp increase in prices in 1974 helped the Soviet Union to generate a hard currency trade surplus. Oil earnings doubled to at least \$2.5 billion. As much as 900,000 b/d may be sold to hard currency countries in 1975 and at \$10 a barrel, earnings would be about \$3.4 billion (Table 1). Western industrial countries have curtailed oil demand and restricted imports, including those from the USSR, and the 900,000 b/d estimate may be high, but oil revenues should reach at least \$3 billion and thus help assure the Soviets another hard currency trade surplus.

While Soviet oil exports to the West may level off, exports of natural gas are to rise sharply during the next few years. Because of the USSR's critical need for large-diameter pipe and ancillary equipment for pipeline construction, it has signed contracts to receive such equipment in exchange for long-term deliveries of natural gas. Soviet exports of natural gas to Western Europe in 1975 will reach 1.2 billion cf/d and expand to about 2.4 billion cf/d in 1980 (Table 2). The USSR was able to renegotiate natural gas prices upward in 1974 talks with Austria and West Germany.

Table 1

USSR: Estimated Oil Supply and Demand
(Million Barrels/Day of Crude Oil Equivalent)

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1980</u>
<u>SUPPLY</u>				
Domestic Production	8.4	9.0	9.6	11.8
Imports	0.3	0.1	0.3	0.4
TOTAL	<u>8.7</u>	<u>9.1</u>	<u>9.9</u>	<u>12.2</u>
<u>DEMAND</u>				
Domestic Consumption	<u>6.4</u>	<u>6.8</u>	<u>7.2</u>	<u>9.2</u>
Available for Export to:	<u>2.3</u>	<u>2.3</u>	<u>2.7</u>	<u>3.0</u>
Eastern Europe	1.1	1.2	1.3	1.4 - 1.8 <u>1/</u>
Other Communist countries	0.3	0.2 <u>2/</u>	0.2 <u>2/</u>	0.2 <u>2/</u>
West for soft currencies	0.2	0.3	0.3	0.2
West for hard currencies	0.7	0.6	0.9	0.8 - 1.2 <u>3/</u>

1. The range of possible Soviet supplies to Eastern Europe affects the amount available for hard currency countries.
2. Includes swap oil for Cuba from hard currency suppliers on Soviet account.
3. Actual Soviet exports to hard currency countries may be reduced by 200,000 b/d of Soviet hard currency imports.

Table 2

USSR: Estimated Natural Gas Supply and Demand
(Billion Cubic Feet/Day)

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1980</u>
<u>SUPPLY</u>				
Domestic Production	22.8	25.2	27.6	36.7
Imports	<u>1.1</u>	<u>1.2</u>	<u>1.4</u>	<u>1.4</u>
TOTAL	23.9	26.4	29.0	38.1
<u>DEMAND</u>				
Domestic Consumption	23.2	25.2	26.6	33.4
Exports	<u>0.7</u>	<u>1.2</u>	<u>2.4</u>	<u>4.7</u>
To Western Europe	0.2	0.4	1.2	2.3
To Eastern Europe	0.5	0.8	1.2	2.4
Net Trade	-0.4	0	1.0	3.3

Henceforth, prices will be tied to fuel oil costs in each of the two countries. As a result of these negotiations and increased deliveries, Soviet hard currency earnings from natural gas sold in Italy, Austria, and West Germany should exceed \$300 million in 1975. By 1980, annual hard currency earnings from these gas sales will amount to \$1.4 billion.

Soviet exports of coal to the West probably will decline slightly in 1975 because of the recession-related necessity to restrict energy consumption and reduce imports. Soviet earnings of hard currency from coal in 1975, however, are likely to rise to perhaps \$70 million as the USSR gets higher prices for the coal it exports.

The Soviet economy has been helped by the improvement in the USSR's terms of trade vis-a-vis the West resulting from high fuel prices. Increased export earnings has allowed the Soviets to step up imports of highly-priced equipment and technology. Equipment imported to increase gas and oil production would help to boost future exports, but the world-wide shortage of such equipment may retard Soviet exploration and development in the next few years.

Eastern Europe is becoming increasingly dependent on the USSR for oil and natural gas. Excluding Romania, which does not import Soviet oil, the remaining five countries of Eastern Europe rely on the USSR for about 85% of their

supplies (Table 3). The remainder is obtained from the West, chiefly as crude oil from the Middle East and North Africa and mainly through barter. The higher price Moscow is charging for oil, although still well below the \$10-\$11 per barrel for Saudi crude, will cost the five countries an additional \$1.5 billion in 1975.

The need for oil in Eastern Europe will continue to rise, and its import bill will also rise, at least for several years, unless oil prices decline sharply in the near future. A new Soviet-East European price formula has been agreed to which calls for an annual revision in oil prices based on the average world price for the preceding 5 years. In addition, Soviet deliveries to Eastern Europe will probably level off in a few years, and Eastern Europe will have to buy more oil from the West. These purchases will be mostly hard currency since barter deals for oil with Arab countries are likely to be limited by Arab reluctance to take large quantities of East European goods.

As the USSR becomes unable or unwilling to increase deliveries of oil, larger supplies of Soviet natural gas will be available for export. Soviet gas reserves are much larger than those for oil, but the equipment and technology required to produce the gas from fields located in remote areas and to transport it by pipeline is costly.

Table 3

Eastern Europe: Estimated Oil Supply and Demand
(Million Barrels/Day of Crude Oil Equivalent)

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1980</u>
<u>SUPPLY</u>				
Domestic Production	0.3	0.3	0.3	0.4
Imports	<u>1.4</u>	<u>1.5</u>	<u>1.7</u>	<u>2.4</u>
From USSR	1.1	1.2	1.3	1.4 - 1.8 <u>1/</u>
From other sources ^{2/}	0.3	0.3	0.4	0.6 - 1.0
TOTAL	<u>1.7</u>	<u>1.8</u>	<u>2.0</u>	<u>2.8</u>
<u>DEMAND</u>				
Domestic Consumption	1.5	1.6	1.8	2.6
Exports ^{3/}	0.2	0.2	0.2	0.2

1. Amount supplied by the USSR affects the amount Eastern Europe must secure from other sources.

2. Includes both hard and soft currency expenditure. The share of purchases requiring hard currency is expected to rise sharply in the future.

3. Romanian sales, mainly for hard currency.

Much of the equipment and capital must come from the West, but a new cooperative venture is now under way in which the five East European countries will assist the USSR in building a 56-inch gas pipeline from Orenburg to Eastern Europe. Estimated Soviet deliveries of natural gas to Eastern Europe in 1975 and 1980 will be about 1.2 and 2.4 billion cf/d, respectively, and account for about one-fourth of total gas supply in 1975 and one-half in 1980.

Future Energy Needs

The growing depletion of resources available near existing population centers in the European USSR has forced the Soviet leadership to look to Siberia to meet future needs and to ponder ways to supply the area with the necessary capital, labor, and technology. The USSR will have to develop Siberian energy reserves, in particular, if it is simultaneously to meet its own rising requirements, satisfy the needs of Eastern Europe, and maintain sizable exports to hard currency areas.

Thus far, the USSR has been developing Siberian resources almost entirely with its own resources. It does not have the capital and, in some cases, the technology to exploit Siberian resources as quickly as it would like. The magnitude of gas and oil reserves and the difficult cold climate

engineering problems involved in their development are reflected in the urgency of Soviet efforts to obtain the assistance of Western capital, equipment, and technology. Without outside assistance, the pace of development of onshore oil and gas resources would be delayed by three to five years or longer; and extensive development of offshore resources would be improbable by 1990.

If the USSR is to remain self-sufficient in energy, the development of Siberian resources is imperative. Total Soviet demand for energy is expected to double during the period 1976-90; 80% of the increase in Soviet production of energy through 1990 will be obtained from Siberia. By 1990 Siberian fields probably will account for about half of total Soviet production of oil and gas.

Impact of the Energy Crisis on Soviet Oil Policy

The energy crisis has had no impact on Soviet oil production policy. Thus far, it has been Soviet policy to produce as much oil as possible -- to meet its own and Eastern European needs and to maximize sales to hard currency countries.

Trade policy has changed only in the sense that the Soviets raised their prices of oil to non-Communist customers -- both hard currency customers and their bilateral trading partners -- following OPEC's lead. And in 1975 they are increasing oil prices to Eastern Europe. Apparently some hard currency customers, such as France, were unwilling to pay Soviet prices in 1974 and reduced oil imports from the USSR. In addition, the Soviets were

unable to import as much as they wanted to on barter from Iraq, the latter demanding world market prices and hard currency. Most of the Iraqi oil obtained on Soviet account is shipped to Eastern Europe. Thus, the USSR had to export additional oil to those countries

In 1975 the Soviets plan to increase oil production, sell more to Eastern Europe and hard currency customers, and obtain more from Iraq on barter. Without barter imports from the Middle East, exports to hard currency countries probably would decline.

If the Soviets are unable to extract as much oil as needed for consumption and exports in the future, they may find it desirable to import more from the Middle East. Although the Iraqis resisted Soviet requests for barter oil in 1974 and cut exports to the USSR sharply this year, they may relent if they can't sell as much as they would like for hard currency. If excess producing capacity continues to be available in OPEC countries in the future as importing countries reduce consumption and/or produce more oil themselves, the Soviets are likely to attempt to procure substantially more oil from Iraq and other Middle East and North African countries by barter. Such procurement if large enough, would ease the pressure on Soviet oil resources.

Soviet View of World Economic Problems

Moscow undoubtedly perceives the current economic maladies in the West with mixed emotions. Moscow propaganda contrasts this latest crisis in capitalism with so-called stable economic conditions in the world socialist system. Moscow's claims of the Communist countries' immunity to world economic ills are being tested, however. Although the Soviet and East European economies will be able to escape the full impact of Western inflation and recession, they are being affected.

Inflation and Recession

According to a recent Izvestiya editorial, the Western world has greeted 1975 with anxiety: business activity is in a slump, production is declining, the unemployment level is climbing to new highs, and inflation is setting new growth records. In contrast, the USSR and East Europeans are looking to the future with confidence. Accordingly, the West Europeans are looking more favorably on establishing closer economic relations with the socialist states and are now following the example of France, "one of the first" to establish close ties with the USSR.

Moscow has played up the advantage to the British workers who will be gainfully employed filling the large orders for the USSR that will be financed by the \$2.3 billion credit line

advanced to Moscow. Also addressing workers' interests, Politburo member Aleksandr Shelepin closed his address at the December 1974 trade union meeting with the Finns by sharply criticizing the European Trade Union Confederation for its lack of aggressiveness in protecting the worker against the growing threat of inflation.

Moscow is worried, however, because as inflation mounts, the cost of imports from the West also increases. While the terms of trade are still in Moscow's favor, the inflationary process in the West with its attendant higher prices for Western manufactured goods is eroding the price advantage recently won by Moscow. The Soviet leaders also must feel uneasy at having to sit on the sidelines while others make the decisions on oil prices.

Constantly rising prices for Western manufactures are making things difficult for Soviet planners. Not only will it be more difficult to plan long-term projects because of increased foreign exchange cost of equipment, but it may also become increasingly difficult to measure the viability of a particular project on economic grounds, because of uncertain capital costs.

The insulation of the world socialist system from Western economic instability also has been dealt a serious blow by the adoption of the new CEMA pricing system which each year will adjust CEMA prices according to average world prices for the previous five years. Accordingly, Western inflation will be imported into CEMA trade and will add to the pricing and planning problems that now exist in East-West trade.

The Raw Materials Problem

Moscow views the raw materials problem as a "graphic new manifestation of the general crisis of capitalism," which in turn is aggravating the West's other economic difficulties. According to Soviet spokesmen, it has increased the instability of the foreign exchange system because the rise in raw material prices has forced some Western countries to borrow funds for balance of payments purposes; the higher raw material prices are being borne by the population who are hit with increased retail prices; ^{and} raw material shortages and attendant higher prices are exacerbating the recession in several key industries, which in turn contribute to a decline in business activity and an increase in unemployment. Moscow places the blame on Western monopolies, which earlier had been exploiting the less developed countries and are now chafing at the bit for having to pay higher prices.

Moscow has benefited, however, from the sharp increases in raw materials prices, which in the last two years have

greatly improved the USSR's terms of trade with the West. Similarly, Moscow's terms of trade with Eastern Europe will improve dramatically this year according to the new CEMA trade pricing system. It appears to be a foregone conclusion that prices for raw materials (Moscow's major exports to Eastern Europe) will rise faster than prices for manufactured goods (Moscow's major imports from Eastern Europe).

Reluctance to Exploit Political Openings

Moscow has been reluctant to extract political gains from economic problems in Europe. Detente comes first and the class struggle comes second, says Soviet Party Secretary Ponomarev. Whereas not so long ago, Moscow was telling the world's communists, particularly those in Europe, that the crisis of capitalism presented them with a greater opportunity than they ever had, Ponomarev is now urging them to go slow. Apparently he is now more concerned with the possibility that the crisis of capitalism may bring fascists into power, particularly in Europe. The political turmoil that would be generated would complicate Soviet relations with the United States as well as adversely affect Soviet detente policies that also are yielding benefits to Moscow. Apparently Moscow is now hopeful that the West, because of its economic crisis, might now be more willing than in the past to accept a real measure of arms limitation and reduction, and thus pursue detente more earnestly.

Table 4
Geographic Distribution of Soviet Trade^{1/}

Area	Million US \$							
	1970		1972		1973		1974	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Total ^{2/}	12,800	11,731	15,416	16,105	21,332	20,980	27,370	24,860
Communist countries	8,367	7,636	10,020	10,307	12,306	12,442	NA	NA
Eastern Europe	6,758	6,633	8,143	9,306	9,964	10,925	11,700 ^{4/}	12,100 ^{4/}
China	25	22	121	134	136	136	NA	NA
Other	1,584	981	1,759	873	2,205	1,381	NA	NA
Free World	4,433	4,095	5,383	5,789	9,027	8,538	NA	NA
Developed West	2,344	2,780	2,884	4,097	4,957	6,124	NA	NA
Less Developed Countries	1,292	1,298	1,426	1,669	1,928	2,391	NA	NA
Unspecified ^{3/}	796	16	1,080	25	2,142	23	NA	NA

1/ All trade statistics are derived from official Soviet statistics, unless otherwise indicated.

2/ Because of rounding, components may not add to the total shown.

3/ Includes Hong Kong.

4/ Estimated.

East European Foreign Trade by Area

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	Imports			Exports		
	1972	1973	1974*	1972	1973	1974*
Eastern Europe						
Total	24234	32693	42128	24543	31824	38412
Eastern Europe	6721	6687	10155	6676	9039	10451
USSR	8222	9993	11713	9335	11029	12075
Other Communist	2014	1369	1620	1183	1456	1706
Developed West	6848	10603	15246	5478	7795	10309
Developing Nations	1429	2041	3384	1871	2523	3641
Bulgaria						
Total	2567	3270	4166	2627	3300	3838
Eastern Europe	629	788*	915	531	710*	815
USSR	1341	1615*	1920	1478	1755*	1945
Other Communist	77	185*	237	109	156*	160
Developed West	349	466*	790	316	400*	510
Developing Nations	171	216*	334	199	279*	408
Czechoslovakia						
Total	4662	6304	7840	4915	6212	7400
Eastern Europe	1488	2064	2455	1530	2063	2250
USSR	1548	1890	2170	1668	1970	2160
Other Communist	260	340	400	275	360	450
Developed West	1056	1553	2140	929	1309	1755
Developing Nations	310	457	675	453	516	785
East Germany						
Total	5905	7876	9015	6184	7542	8780
Eastern Europe	1641	2334	2520	1904	2365	2745
USSR	2069	2469	2785	2485	2850	3095
Other Communist	215	254	235	275	306	340
Developed West	1777	2524	3054	1277	1694	2200
Developing Nations	203	275	371	243	326	400
Hungary						
Total	3154	4076	5576	3291	4594	5127
Eastern Europe	835	1057	1385	967	1406	1677
USSR	1094	1389	1635	1188	1534	1552
Other Communist	97	123	149	142	193	215
Developed West	651	1178	1879	739	1126	1213
Developing Nations	227	329	528	255	335	469
Poland						
Total	5330	7862	10471	4927	6432	8332
Eastern Europe	1491	1943	2035	1154	1633	2014
USSR	1591	1916	2353	1816	2082	2373
Other Communist	180	203	249	161	188	250
Developed West	1172	3431	5153	1397	2063	2816
Developing Nations	296	369	676	399	466	879
Romania						
Total	2616	3505	5060	2599	3738	4935
Eastern Europe	537	701	855	530	852	950
USSR	579	694	850	700	829	950
Other Communist	185	264	330	221	253	290
Developed West	1043	1451	2225	826	1203	1615
Developing Nations	222	395	600	322	601	900

*Estimated.